

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

| | | | |
|--|--------------------------|--|----------------------|
| Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other | | Local Government Name: <u>Three Rivers Health</u> | County St. Joseph |
| Audit Date 12/31/04 | Opinion Date 02/17/05 | Date Accountant Report Submitted To State: | |

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:


1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

| We have enclosed the following: | Enclosed | To Be Forwarded | Not Required |
|---|--------------------------|--------------------------|-------------------------------------|
| The letter of comments and recommendations. | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| Reports on individual federal assistance programs (program audits). | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| Single Audit Reports (ASLGU). | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |

| | | | |
|---|-----------------|-------------|--------------|
| Certified Public Accountant (Firm Name): PLANTE & MORAN, PLLC | | | |
| Street Address 750 Trade Centre Way, Suite 300 | City Portage | State MI | ZIP 49002 |
| Accountant Signature  | | | |

Three Rivers Health

Consolidated Financial Report
December 31, 2004

Three Rivers Health

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Independent Auditor's Report

To the Board of Trustees
Three Rivers Health

We have audited the accompanying consolidated balance sheet of Three Rivers Health as of December 31, 2004 and 2003 and the related consolidated statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Three Rivers Health at December 31, 2004 and 2003 and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements do not present the management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be part of, the basic financial statements.

Plante & Moran, PLLC

February 17, 2005

Three Rivers Health

Consolidated Balance Sheet

| | December 31, 2004 | December 31, 2003 |
|--|----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents (Note 2) | \$ 1,320,189 | \$ 1,029,159 |
| Accounts receivable (Note 4) | 4,661,222 | 4,127,411 |
| Assets limited as to use (Note 3) | 130,334 | 158,160 |
| Other current assets | 1,028,621 | 935,172 |
| Total current assets | 7,140,366 | 6,249,902 |
| Assets Limited as to Use (Note 3) | 5,852,558 | 3,493,327 |
| Property and Equipment (Note 5) | 14,042,899 | 13,647,072 |
| Total assets | \$ 27,035,823 | \$ 23,390,301 |
| Liabilities and Net Assets | | |
| Current Liabilities | | |
| Current portion of long-term debt (Note 6) | \$ 1,179,946 | \$ 1,120,262 |
| Accounts payable | 1,352,680 | 692,881 |
| Cost report settlements payable | 1,100,000 | 1,050,000 |
| Accrued liabilities and other: | | |
| Accrued compensation | 154,477 | 294,964 |
| Accrued compensated absences | 805,969 | 681,760 |
| Construction payable | 243,057 | - |
| Other accrued liabilities | 351,663 | 310,590 |
| Total current liabilities | 5,187,792 | 4,150,457 |
| Long-term Debt (Note 6) | 11,149,591 | 9,411,660 |
| Total liabilities | 16,337,383 | 13,562,117 |
| Net Assets | | |
| Invested in capital assets - Net of related debt | 4,220,018 | 993,635 |
| Restricted for debt service | 130,334 | 1,413,160 |
| Restricted for capital acquisitions | 2,290,625 | - |
| Unrestricted | 4,057,463 | 7,421,389 |
| Total net assets | 10,698,440 | 9,828,184 |
| Total liabilities and net assets | \$ 27,035,823 | \$ 23,390,301 |

Three Rivers Health

Consolidated Statement of Revenues, Expenses, and Changes in Net Assets

| | Year Ended | |
|---|----------------------|----------------------|
| | December 31, 2004 | December 31, 2003 |
| Operating Revenues | | |
| Net patient service revenue | \$ 37,969,979 | \$ 33,577,193 |
| Other | 458,618 | 222,067 |
| Total operating revenues | 38,428,597 | 33,799,260 |
| Operating Expenses | | |
| Salaries and wages | 14,827,298 | 13,882,985 |
| Employee benefits and payroll taxes | 4,456,901 | 4,085,854 |
| Operating supplies and expenses | 4,007,270 | 3,358,517 |
| Professional services and consultant fees | 3,840,058 | 3,053,112 |
| Purchased services | 4,804,663 | 4,514,545 |
| Professional liability costs | 1,404,372 | 905,625 |
| Utilities | 455,999 | 444,339 |
| Repairs and rentals | 752,633 | 653,865 |
| Other | 770,912 | 708,004 |
| Depreciation and amortization | 1,844,991 | 1,839,974 |
| Total operating expenses | 37,165,097 | 33,446,820 |
| Operating Income | 1,263,500 | 352,440 |
| Nonoperating Revenues (Expenses) | | |
| Interest income | 67,464 | 77,285 |
| Contributions | 72,013 | 199,206 |
| Interest expense | (532,721) | (597,027) |
| Total nonoperating revenues (expenses) | (393,244) | (320,536) |
| Excess of Revenues Over Expenses | 870,256 | 31,904 |
| Increase in Net Assets | 870,256 | 31,904 |
| Net Assets - Beginning of year | 9,828,184 | 9,796,280 |
| Net Assets - End of year | <u>\$ 10,698,440</u> | <u>\$ 9,828,184</u> |

Three Rivers Health

Consolidated Statement of Cash Flows

| | Year Ended | |
|---|----------------------|----------------------|
| | December 31, 2004 | December 31, 2003 |
| Cash Flows from Operating Activities | | |
| Cash received from residents and third-party payors | \$ 37,421,020 | \$ 33,308,605 |
| Cash paid to employees and suppliers | (34,663,810) | (32,227,883) |
| Other operating receipts | 458,618 | 222,067 |
| Net cash provided by operating activities | 3,215,828 | 1,302,789 |
| Cash Flows from Noncapital Financing Activities - | | |
| Donations | 72,013 | 199,206 |
| Cash Flows from Investing Activities | | |
| Proceeds from sale of investments | 334,995 | 696,773 |
| Interest received | 67,464 | 77,285 |
| Purchase of investments | - | (1,952,305) |
| Net cash provided by (used in) investing activities | 402,459 | (1,178,247) |
| Cash Flows from Capital and Related Financing Activities | | |
| Proceeds received on bonds | 4,100,000 | 1,500,000 |
| Principal payments on long-term debt | (2,464,096) | (1,116,324) |
| Interest paid on long-term debt | (532,721) | (597,027) |
| Purchase of property and equipment | (1,836,053) | (879,642) |
| Net cash used in capital financing activities | (732,870) | (1,092,993) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 2,957,430 | (769,245) |
| Cash and Cash Equivalents - Beginning of year | 2,672,508 | 3,441,753 |
| Cash and Cash Equivalents - End of year | \$ 5,629,938 | \$ 2,672,508 |
| Balance Sheet Classification of Cash | | |
| Current assets | \$ 1,320,189 | \$ 1,029,159 |
| Assets limited as to use | 4,309,749 | 1,643,349 |
| Total cash | \$ 5,629,938 | \$ 2,672,508 |

Three Rivers Health

Consolidated Statement of Cash Flows

| | Year Ended | |
|--|----------------------|----------------------|
| | December 31, 2004 | December 31, 2003 |
| Reconciliation of Operating Income to Net Cash from Operating Activities | 1,263,500 | 352,440 |
| Adjustments to reconcile operating income to net cash from operating activities: | | |
| Depreciation | 1,844,993 | 1,839,974 |
| Provision for bad debts | 2,974,770 | 2,544,296 |
| Change in assets and liabilities: | | |
| Accounts receivable | (3,573,730) | (3,312,884) |
| Cost report settlement receivables | - | 200,000 |
| Other current assets | (268,246) | (218,954) |
| Increase (decrease) in accounts payable | 659,800 | (162,517) |
| Increase (decrease) in other accrued expenses | 264,741 | (239,566) |
| Increase in third-party settlement payables | 50,000 | 300,000 |
| Net cash provided by operating activities | \$ 3,215,828 | \$ 1,302,789 |

Significant noncash investing, capital, and financing activities for 2004 and 2003 are as follows:

In 2004 and 2003, the Hospital leased equipment under capital leases. These obligations were for \$161,711 and \$185,845 in 2004 and 2003, respectively.

In 2004, the Hospital had \$243,057 due on a construction payable for assets included in property and equipment.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies

Three Rivers Health changed its name from Three Rivers Area Hospital Authority during the year ended December 31, 2004. Three Rivers Health (the "Hospital") is a governmental unit that operates a short-term acute care facility providing inpatient and outpatient health care services to the Three Rivers, Michigan area. TRAH Properties, a wholly owned subsidiary of the Hospital, leases space to the Hospital for services provided to its patients. Integrated Health Systems (IHS), a wholly-owned subsidiary of the Hospital, employs physicians who work at the Hospital as contracted employees. Physicians Health Organization (PHO) is a joint venture between the Hospital and local physicians to provide computer services, as well as a 50-50 risk share pool to doctors who refer patients to the Hospital. The Hospital also established a foundation during 2004, whose purpose is to obtain funds to directly benefit the Hospital.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation - The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital now follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provide a comprehensive look at the Hospital's financial activities. No component units are required to be reported in the Hospital's financial statements.

Enterprise Fund Accounting - The Hospital uses Enterprise Fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Affiliated Organization - The Hospital has a formal agreement with a local health care provider whereby both organizations will work toward the mutual benefit of one another in furtherance of promoting an integrated health care delivery system in southwest Michigan. The Hospital has available the technical and financial resources of its affiliate and participates in the affiliate's sponsored managed care programs. This affiliation agreement terminates October 31, 2008.

Assets Limited as to Use - Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. Also, funds are restricted for future bond payments and capital projects.

Investments - Investments are carried at fair value.

Property and Equipment - Property and equipment are stated at cost. Maintenance and repairs are charged to expense as incurred. Depreciation has been charged to operations using the straight-line method and includes amortization of capital leases.

Paid Time Off - The Hospital maintains a paid time off benefit policy. The benefits are charged to operations when earned. Unused benefits are recorded as a current liability in the financial statements.

Classification of Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. Unrestricted net assets are remaining net assets that do not meet the definition of the other two categories of net assets. Included in the unrestricted net assets reported at December 31, 2004 and 2003 is \$3,561,933 and \$2,238,327, respectively, which has been designated by the Hospital's Board of Trustees for future capital acquisitions. Designated funds remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Net Patient Service Revenue - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care was less than 1 percent of gross charges for the years ended December 31, 2004 and 2003.

Operating Revenue and Expenses - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Nonoperating activities, including investment income and contributions received for purposes other than capital asset acquisition, and interest expense, are reported as nonoperating revenue and expense.

Tax Status - The Hospital and TRAH Properties are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. IHS is deemed a corporation and files an 1120, with no tax due and PHO files a 1065 partnership return.

Reclassification - Certain prior year amounts have been reclassified to conform to the current year presentation.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 2 - Deposits and Investments

The Hospital's deposits and investments are included on the balance sheet under the following classifications:

| 2004 | Cash and Cash Equivalents | Assets Limited as to Use | Total |
|-------------|---------------------------------|--------------------------------|---------------------|
| Deposits | \$ 1,320,189 | \$ 4,309,749 | \$ 5,629,938 |
| Investments | - | 1,661,725 | 1,661,725 |
| Total | <u>\$ 1,320,189</u> | <u>\$ 5,971,474</u> | <u>\$ 7,291,663</u> |
| 2003 | Cash and Cash Equivalents | Assets Limited as to Use | Total |
| Deposits | \$ 1,029,159 | \$ 1,643,349 | \$ 2,672,508 |
| Investments | - | 1,996,434 | 1,996,434 |
| Total | <u>\$ 1,029,159</u> | <u>\$ 3,639,783</u> | <u>\$ 4,668,942</u> |

The above amounts are classified by Governmental Accounting Standards Board Statement Number 3 in the following categories:

Deposits - The above deposits were reflected in the accounts of the bank (without recognition of checks written but not cleared or of deposits in transit) at \$3,371,257 and \$3,389,044 at December 31, 2004 and 2003, respectively. Of those amounts, \$300,000 was covered by federal depository insurance for both 2004 and 2003, and the remainder was uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. The Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Investments - The Hospital is authorized by Michigan Public Act 20 of 1943 (as amended) to invest surplus monies (of nonpension funds) in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers' acceptances and mutual funds, and investment pools that are composed of authorized investment vehicles.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 2 - Deposits and Investments (Continued)

The Hospital's investments are categorized below to give an indication of the level of risk assumed by the entity. Risk Category 1 includes those investments that meet any one of the following criteria:

- a. Insured
- b. Registered
- c. Held by the Hospital or its agent

Risk Categories 2 and 3 include investments that are neither insured nor registered. Category 2 includes investments that are held by the counterparty's trust department (or agent) in the Hospital's name. Category 3 includes investments held by:

- a. The counterparty or
- b. The counterparty's trust department (or agent) but not in the Hospital's name

| | Category | | | Carrying Amount |
|-------------------------------|-------------|-------------|-------------------|---------------------|
| 2004 | 1 | 2 | 3 | |
| U.S. government securities | \$ - | \$ - | \$ 473,357 | \$ 473,357 |
| Bonds | - | - | 75,201 | 75,201 |
| Total categorized investments | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 548,558</u> | 548,558 |
| Mutual funds | | | | <u>1,113,167</u> |
| Total investments | | | | <u>\$ 1,661,725</u> |

| | Category | | | Carrying Amount |
|-------------------------------|-------------|-------------|---------------------|---------------------|
| 2003 | 1 | 2 | 3 | |
| U.S. government securities | \$ - | \$ - | \$ 937,908 | \$ 937,908 |
| Bonds | - | - | 90,673 | 90,673 |
| Total categorized investments | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 1,028,581</u> | 1,028,581 |
| Mutual funds | | | | <u>967,853</u> |
| Total investments | | | | <u>\$ 1,996,434</u> |

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 2 - Deposits and Investments (Continued)

The Hospital routinely invests its surplus operating funds in money market and mutual funds. These funds generally invest in highly liquid U.S. governmental and agency obligations. Investments in money market and mutual funds are not insured or guaranteed by the U.S. government, but are registered with the SEC; however, management believes that credit risk related to these investments is minimal.

Note 3 - Assets Limited as to Use

The detail of assets limited as to use is summarized in the following schedule:

| | 2004 | 2003 |
|--|---------------------|---------------------|
| Current assets: | | |
| Restricted under the terms of the bond agreement for debt service: | \$ 130,334 | \$ 158,160 |
| Noncurrent assets: | | |
| Restricted under the terms of the bond agreement for capital expansion project | 2,290,625 | - |
| Restricted under the terms of the bond agreement for bond repayment | - | 1,255,000 |
| Designated by Board for future capital acquisitions: | | |
| Cash and investments | 3,550,515 | 2,226,623 |
| Accrued interest receivable | 11,418 | 11,704 |
| Total assets limited as to use | 5,982,892 | 3,651,487 |
| Less current portion | 130,334 | 158,160 |
| Total long-term assets limited as to use | <u>\$ 5,852,558</u> | <u>\$ 3,493,327</u> |

Note 4 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below.

| | 2004 | 2003 |
|---------------------------------------|---------------------|---------------------|
| Patient accounts receivable | \$ 10,725,222 | \$ 10,072,411 |
| Less: | | |
| Allowance of uncollectible accounts | 1,387,000 | 1,145,000 |
| Allowance for contractual adjustments | 4,677,000 | 4,800,000 |
| Net patient accounts receivable | <u>\$ 4,661,222</u> | <u>\$ 4,127,411</u> |

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2004 are summarized below:

| | January 1, 2003 | Additions | Transfers | December 31, 2004 | Depreciable Life - Years |
|---|-----------------|------------|-----------|-------------------|--------------------------|
| Land | \$ 219,500 | \$ - | \$ - | \$ 219,500 | |
| Land and land improvements | 903,382 | 120,451 | - | 1,023,833 | 5-25 |
| Buildings and improvements | 12,727,267 | 118,378 | 172,999 | 13,018,644 | 10-40 |
| Furniture, fixtures, and equipment | 16,046,223 | 645,462 | 775,524 | 17,467,209 | 3-20 |
| Building and equipment under capital lease | 4,285,919 | 161,711 | (948,523) | 3,499,107 | 3-40 |
| Construction in progress | - | 1,194,816 | - | 1,194,816 | |
| Total | 34,182,291 | 2,240,818 | - | 36,423,109 | |
| Less accumulated depreciation: | | | | | |
| Land and land improvements | 671,552 | 35,238 | - | 706,790 | |
| Building and improvements | 5,403,233 | 682,317 | 49,381 | 6,134,931 | |
| Furniture, fixtures and equipment | 13,260,909 | 950,428 | 624,502 | 14,835,839 | |
| Buildings and equipment under capital lease | 1,199,525 | 177,008 | (673,883) | 702,650 | |
| Total | 20,535,219 | 1,844,991 | - | 22,380,210 | |
| Net carrying value | \$ 13,647,072 | \$ 395,827 | \$ - | \$ 14,042,899 | |

Cost of capital assets and related depreciable lives for December 31, 2003 are summarized below:

| | January 1, 2002 | Additions | Transfers | December 31, 2003 | Depreciable Life - Years |
|---|-----------------|--------------|-----------|-------------------|--------------------------|
| Land | \$ 219,500 | \$ - | \$ - | \$ 219,500 | |
| Land and land improvements | 891,674 | 11,708 | - | 903,382 | 5-25 |
| Buildings and improvements | 12,347,175 | 380,092 | - | 12,727,267 | 10-40 |
| Furniture, fixtures, and equipment | 15,558,381 | 487,842 | - | 16,046,223 | 3-20 |
| Buildings and equipment under capital lease | 4,100,074 | 185,845 | - | 4,285,919 | 3-40 |
| Total | 33,116,804 | 1,065,487 | - | 34,182,291 | |
| Less accumulated depreciation: | | | | | |
| Land and land improvements | 638,052 | 33,500 | - | 671,552 | |
| Buildings and improvements | 4,707,587 | 695,646 | - | 5,403,233 | |
| Furniture, fixtures, and equipment | 12,411,262 | 849,647 | - | 13,260,909 | |
| Buildings and equipment under capital lease | 938,344 | 261,181 | - | 1,199,525 | |
| Total | 18,695,245 | 1,839,974 | - | 20,535,219 | |
| Net carrying value | \$ 14,421,559 | \$ (774,487) | \$ - | \$ 13,647,072 | |

At December 31, 2004, the Hospital had commitments related to renovations and expansion of the Urgent Care/Emergency Department and Testing Unit clinical space and the expansion and remodeling of other specific areas of the Hospital. The projected cost to complete the projects is \$3,785,000.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 6 - Long-term Debt

Long-term liability activity for the year ended December 31, 2004 was as follows:

| | December 31, 2003 | Current Year Additions | Current Year Reductions | December 31, 2004 | Amounts Due Within One Year |
|----------------------------|----------------------|------------------------------|----------------------------|----------------------|-----------------------------------|
| Series 1993 | \$ 3,745,000 | \$ - | \$ (525,000) | \$ 3,220,000 | \$ 545,000 |
| Series 1997 | 2,551,000 | - | (230,000) | 2,321,000 | 250,000 |
| Series 2003 | 1,437,934 | - | (1,437,934) | - | - |
| Series 2004 | - | 4,100,000 | - | 4,100,000 | 166,966 |
| Lease payable to affiliate | 2,523,255 | - | (120,386) | 2,402,869 | 106,362 |
| Lease payable | 274,733 | 161,711 | (150,774) | 285,670 | 111,618 |
| Total long-term debt | <u>\$ 10,531,922</u> | <u>\$ 4,261,711</u> | <u>\$ (2,464,094)</u> | <u>\$ 12,329,539</u> | <u>\$ 1,179,946</u> |

Long-term liability activity for the year ended December 31, 2003 was as follows:

| | December 31, 2002 | Current Year Additions | Current Year Reductions | December 31, 2003 | Amounts Due Within One Year |
|----------------------------|----------------------|------------------------------|----------------------------|----------------------|-----------------------------------|
| Series 1993 | \$ 4,240,000 | \$ - | \$ (495,000) | \$ 3,745,000 | \$ 525,000 |
| Series 1997 | 2,771,000 | - | (220,000) | 2,551,000 | 240,000 |
| Series 2003 | - | 1,500,000 | (62,066) | 1,437,934 | 124,617 |
| Lease payable to affiliate | 2,706,596 | - | (183,341) | 2,523,255 | 114,363 |
| Lease payable | 244,805 | 185,845 | (155,917) | 274,733 | 116,282 |
| Total long-term debt | <u>\$ 9,962,401</u> | <u>\$ 1,685,845</u> | <u>\$ (1,116,324)</u> | <u>\$ 10,531,922</u> | <u>\$ 1,120,262</u> |

The bonds payable are summarized as follows:

- Bonds payable - 1993 Series, total annual principal payments ranging from \$545,000 due in 2005 to \$715,000 due in 2009, collateralized by net revenue derived from the operations of the Hospital. At December 31, 2004, the variable interest rate was 5.44 percent.
- Bonds payable - 1997 Series, total annual principal payments ranging from \$250,000 due in 2005 to \$370,000 due in 2011, with the last payment of \$201,000 scheduled to be made in May 2012, collateralized by net revenue derived from the operations of the Hospital. At December 31, 2004, the variable interest rate was 5.44 percent.

Three Rivers Health

Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 6 - Long-term Debt (Continued)

- Bonds payable - 2004 Series, total annual principal payments ranging from \$166,966 due in 2005 to \$270,485 due in 2024. The Hospital used the proceeds from the 2004 bonds to repay the outstanding balance on the 2003 bonds. The 2003 bonds were retired during the year ended December 31, 2004 and are no longer outstanding. The Hospital also entered into an interest rate swap agreement with \$2,460,000 of this debt, fixing the interest rate at 4.58 percent for five years. The remaining debt is at a variable rate that changes on a weekly basis, and was 5.44 percent at December 31, 2004. The debt is collateralized by the net revenue derived from the operations of the Hospital.
- Lease payable to an affiliate organization, monthly installments aggregating approximately \$20,500, including interest at 6.0 percent per annum, collateralized by two buildings.
- Lease payable, monthly installments aggregating approximately \$10,000, including interest at 5.2 - 7.2 percent per annum, collateralized by equipment.

The following is a schedule by years of bond principal and interest as of December 31, 2004:

| Year Ending December 31 | Long-term Debt | | Capital Lease Obligation | |
|-------------------------|---------------------|---------------------|--------------------------|---------------------|
| | Principal | Interest | Principal | Interest |
| 2005 | \$ 961,966 | \$ 403,465 | \$ 217,980 | \$ 151,267 |
| 2006 | 1,038,897 | 371,680 | 201,957 | 139,515 |
| 2007 | 1,093,797 | 316,863 | 204,337 | 127,996 |
| 2008 | 1,143,534 | 259,734 | 126,790 | 118,487 |
| 2009 | 1,204,059 | 199,756 | 134,480 | 110,797 |
| 2010-2014 | 1,840,272 | 526,044 | 805,106 | 421,279 |
| 2015-2019 | 1,086,999 | 297,577 | 997,887 | 146,255 |
| 2020-2024 | 1,271,476 | 113,100 | - | - |
| Total payments | <u>\$ 9,641,000</u> | <u>\$ 2,488,219</u> | <u>\$ 2,688,537</u> | <u>\$ 1,215,596</u> |

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Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 7 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 76 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross Blue Shield of Michigan programs. Subsidiaries of the Hospital have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors are as follows:

- **Medicare** - Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Inpatient rehabilitation services are reimbursed at cost subject to a per case limit. Outpatient services related to Medicare beneficiaries are reimbursed based on an established fee-for-service methodology.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient services are reimbursed on an established fee-for-service methodology.
- **Blue Cross/Blue Shield of Michigan** - The Hospital is reimbursed its controlled charges for services provided to Blue Cross subscribers.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

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Notes to Consolidated Financial Statements December 31, 2004 and 2003

Note 8 - Defined Contribution Pension Plan

The Hospital maintains a defined contribution retirement plan covering substantially all employees. The Hospital has recognized contribution expense totaling \$451,214 and \$442,775 during the years ended December 31, 2004 and 2003, respectively. Expense was determined in accordance with the plan formula that is as follows:

- 1) An employer discretionary contribution that is based on the proportion of each participant's compensation to the compensation of all participants. A participant is defined as an employee who is classified by the Hospital as full-time or part-time and meets minimum hour requirements per pay period.
- 2) An employee matching contribution of half of an employee's contribution up to a maximum of 2 percent.

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for property loss, fraud, director and officer liability, professional liability, malpractice, general liability, employee medical, and workers' compensation claims.

The Hospital is insured against medical malpractice claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim or aggregate claims exceeding claim limits asserted in the policy year. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

There are several pending malpractice claims against the Hospital. There is insurance coverage, but it is possible that the liability for the claims may exceed the aggregate insurance coverage. Presently, it is not possible to determine the resolution of the claims or amount of liability, if any. Accruals for estimated deductibles are included in current liabilities at December 31, 2004 and 2003.